Indian Economy · GS - III

Explain how the Fiscal Health Index (FHI) can be used as a tool for assessing the fiscal performance of states in India. In what way would it encourage the states to adopt prudent and sustainable fiscal policies?

EXAM YEAR	PAPER	SUBJECT
2025	GS - III	Indian Economy

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Fiscal Health Index, NITI Aayog, fiscal sustainability, revenue mobilisation, expenditure quality, debt management, fiscal prudence, inter-state comparison, FRBM

Model Answer

Introduction

The Fiscal Health Index (FHI), developed by NITI Aayog, provides a comparative framework for assessing the fiscal performance of Indian States. It shifts attention from the size of expenditure towards its quality, sustainability and revenue capacity.

1. FHI as an assessment tool

The index evaluates States through dimensions such as expenditure quality, revenue mobilisation, fiscal prudence and debt sustainability. It enables comparison across States and identification of structural weaknesses.

A State with strong own-tax revenue, productive capital expenditure and sustainable debt would demonstrate stronger fiscal health than one dependent heavily on borrowings and committed expenditure.

2. Encouraging fiscal prudence

FHI can encourage States to:

1. Improve own-source revenue through better tax administration.
2. Shift expenditure from subsidies and unproductive revenue expenditure towards capital formation.
3. Maintain sustainable debt and control fiscal deficits.
4. Improve the quality and efficiency of public spending.
5. Benchmark performance against better-performing States.
6. Integrate fiscal planning with long-term development objectives.

It can also strengthen evidence-based policy discussions between States, the Finance Commission and the Union.

3. Limitations

Inter-State comparison must account for differences in resource endowment, demographic structure, development needs and disaster vulnerability. The index should therefore complement, not replace, State-specific fiscal analysis.

Conclusion

FHI can create a culture of fiscal accountability by linking fiscal performance with measurable outcomes. Combined with greater transparency and medium-term fiscal planning, it can strengthen India's fiscal federalism and long-term financial sustainability.

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